

Internal Revenue Service

Number: **200702024**

Release Date: 1/12/2007

Index Number: 1361.03-03

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

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Refer Reply To:

CC:PSI:B02

PLR-129058-06

Date:

October 11, 2006

X =

Trust =

LLC =

D1 =

D2 =

D3 =

Dear :

This responds to a letter dated June 7, 2006, submitted on behalf of X by its authorized representative, requesting a ruling as to whether Trust qualified as an electing small business trust (ESBT) under § 1361(e) of the Internal Revenue Code.

The information submitted states that X elected to be treated as an S corporation effective D1. Prior to D1, Trust and LLC both owned shares of X and Trust owned an interest in LLC, which is a partnership for federal income tax purposes. LLC distributed its X stock to Trust so that X would be eligible to make an S corporation election. Trust was initially an eligible S corporation shareholder under § 1361(c)(2)(A)(ii). The trustee of Trust made an ESBT election for Trust, intended to be effective D2, within the two-year period described in § 1361(c)(2)(A)(ii).

The governing instrument creating Trust provides that at the termination of Trust, the trustee shall distribute the Trust assets other than the interest in the LLC to the LLC. The trustee shall then distribute the Trust's interest in the LLC to or for the benefit of the grantor's descendants in a manner described elsewhere in the governing instrument.

The operating agreement of LLC provides that if a member contributes additional cash or other assets to LLC, the fair market value of the new contribution will be allocated to the capital account of the contributing member. The membership percentage of a member contributing assets will be increased. X represents that the contribution of Trust assets to LLC pursuant to the governing instrument would qualify as an exchange under § 721 that would not result in gain or loss to LLC or Trust.

The shareholders' agreement of X provides that transfer of any X stock to any corporation, partnership, limited liability company, or other entity is prohibited. The trustee of Trust entered into the shareholders' agreement as of D1.

X represents that pursuant to X's shareholders' agreement and the trustee's authority under Trust's governing instrument, none of the assets of Trust, including the stock of X, have been distributed to LLC. All of the outstanding stock of X was acquired on D2 by an S corporation, which elected to treat X as a qualified subchapter S subsidiary (QSub) effective D3.

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien (NRA) as a shareholder, and (D) have more than one class of stock.

Section 1361(c)(2)(A)(v) provides that, for purposes of § 1361(b)(1)(B), an ESBT may be a shareholder of an S corporation. Section 1361(e) defines an ESBT. Section 1361(e)(1)(A) provides that, except as provided in § 1362(e)(2)(B), an ESBT means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2), (3), (4), or (5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section § 1.1361-1(m)(2)(ii)(A) of the Income Tax Regulations provides, in general, that a beneficiary includes a person who has a present, remainder, or reversionary interest in a trust.

Based solely on the facts and representations submitted, we conclude that LLC is not a beneficiary of Trust for purposes of §§ 1361(c)(2)(A)(v) and 1.1361-1(m)(2)(ii)(A) and therefore Trust was not ineligible to elect to be an ESBT because of

the provision in Trust's governing instrument regarding the distribution of Trust property to LLC for the period beginning D2 and ending D3.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file, a copy of this letter is being sent to X's authorized representatives.

Sincerely,

J. THOMAS HINES
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes